United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

75-7518

To be argued by
C. MacNEIL MITCHELL

United States Court of Appeals
FOR THE SECOND CIRCUIT

B

TELEDYNE INDUSTRIES, INC.,

Plaintiff-Appellee,

against

P/S

ODIF PODELL, SIMON SKYBNIK, NICHOLAS ANTON, SAUL WALLER,

Defendants-Appellants,

and

[illegible] CORPORATION and KERNS MANUFACTURING CORP.,

Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF PLAINTIFF-APPELLEE
(Judgment After Trial)

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United States Court of Appeals
FOR THE SECOND CIRCUIT

TELEDYNE INDUSTRIES, INC.,

Plaintiff-Appellee,

against

ODIF PODELL, SIMON SRYBNIK, NICHOLAS ANTON, SAUL WALLER,

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and

EON CORPORATION and KERNS MANUFACTURING CORP.,

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR PLAINTIFF-APPELLEE TELEDYNE INDUSTRIES, INC.

Preliminary Statement

This is an appeal from a joint and several judgment against appellants for money damages filed August 8, 1975 after a 12-day bench trial of a diversity action for conversion and breach of trust in the United States District Court for the Southern District of New York (Knapp, J.).

Statement of the Issues Presented for Review

1. Was Judge Knapp's finding that plaintiff-appellee had a legal or equitable interest in the contents of a "special" bank account sufficient under California law to render the funds therein capable of being converted or misappropriated in breach of trust "clearly erroneous," given due regard for his conclusions as to the credibility of witnesses?

2. Assuming that such a finding was not "clearly erroneous," did Judge Knapp err in holding defendants-appellants jointly and severally liable under California law for their participation in acts of conversion and breach of trust, again given due regard for his conclusions as to the credibility of witnesses?

Statement of the Case

The nature of the case and parties

Plaintiff-appellee Teledyne Industries, Inc. ("Teledyne")* is a California corporation engaged in the manufacture and sale of, *inter alia*, a certain model 1.5 kilowatt diesel generator set. (FSN 6115-889-1446) (the "generator set"). Defendant Eon Corporation ("Eon") is a New York corporation formerly engaged, through its American Marc division, in manufacturing and selling similar generator sets to the U.S. Army. The individual defendants-appellants ("appellants") Odif Podell ("Podell"), Simon Srybnik ("Srybnik"), Nicholas Anton ("Anton") and Saul Waller ("Waller") were at all relevant times directors of Eon. Podell, Anton and Waller also comprised Eon's chief executive and operating officers. Srybnik was, in addition, the principal stockholder of Eon, having acquired in his own name and through affiliates a 44.99% controlling interest (A701)** in Eon by "rescuing" it from an earlier Chapter XI proceeding in 1967. M. James Leonard ("Leonard"), although not a party hereto,*** was an Eon director, vice-president and full-time employee through January 21, 1972, after which he relinquished his office and directorship, but stayed on as a part-time employee and paid consultant of Eon.

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* Teledyne's Teledyne Continental Motors Division (sometimes referred to as "TCM"), with its headquarters in Michigan, is the precise Teledyne division involved in this action. Reference hereinafter to "Teledyne" includes TCM.

** References prefixed "A" are to the joint appendix on appeal.

*** Teledyne determined not to join Leonard, who was not an indispensable party, solely on the ground that Leonard's California citizenship would destroy diversity of citizenship.

In 1969 Eon had entered into a fixed-price contract with the U.S. Army (the "Army Contract") pursuant to which Eon was to manufacture and deliver approximately 8,800 generator sets. The contract was in two parts, being divided almost equally into a "first year" and a "second year" procurement. In early 1971, Eon's directors determined to sell off or close down the plant which manufactured their generator sets. Since the Army Contract was still in its "first year" procurement stage, appellants realized that Eon would have to subcontract the "second year" procurement portion to another manufacturer in order to be able to accomplish their goal.

On May 12, 1971, Eon, acting through Leonard and Anton, subcontracted out to Teledyne the "second year" procurement portion of the Army Contract by means of a written purchase order (the "Subcontract"). At the same time, since the U.S. Army would be paying Eon for Teledyne's work, Eon agreed to set up what it termed a "special account" at the Palos Verdes branch of the Bank of America (the "Special Account") for the purpose of depositing all payments (including advance or "progress payments") to be received by Eon from the U.S. Army as a result of and allocable under the Subcontract to Teledyne's manufacture and delivery of "second year" generator sets (the "Army Payments").

Thereafter, Teledyne was inspected and approved by the U.S. Army's quality assurance section as a subcontractor for the generator sets. Beginning on November 22, 1971, Teledyne began shipments, delivering directly to the U.S. Army but invoicing Eon under the Subcontract.* While Teledyne initially received its Army Payments from Eon out of the Special Account, by June of 1972 Teledyne began to suspect that it had not received all the Army Payments. After representatives of Teledyne and Eon met in New York to discuss this on June 29 and again on July 17 and

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* Since Eon had refused to "novate" the Army Contract (*See infra* at 9), the U.S. Army would not pay Teledyne directly, but insisted that all its financial dealings thereunder remain only with Eon.

18, 1972, it became apparent that Eon, at the express direction of its board of directors—*i.e.*, appellants—had withdrawn certain Army Payments from the Special Account for other uses. At the same time, Teledyne also discovered that, from the beginning of the Subcontract, there had been insufficient Army Payments remaining unpaid under the Army Contract to have paid Teledyne under the Subcontract, even if every penny received by Eon after that date had gone to Teledyne.* Shortly thereafter this action was commenced.

Fairly summarized, the essential findings of Judge Knapp which are questioned on this appeal involve his interpretation of the nature and purpose of the Special Account, as interpreted in light of the written documents and oral testimony.

The pleadings

Teledyne brought suit in the District Court against Eon, appellants, Podell, Srybnik, Anton and Waller, and Kerns Manufacturing Corporation.** The complaint (A7) first averred in its first claim that Eon, with the knowledge, consent and participation of appellants, fraudulently induced Teledyne to enter into the Subcontract by falsely representing that sufficient Army Payments then remained unpaid under the Army Contract to satisfy Eon's entire projected monetary obligation to Teledyne under the Subcontract.

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* This was because Eon had been receiving "progress payments" (essentially advances based on a percentage of incurred costs) from the U.S. Army. These "progress payments" ultimately reduced the amounts Eon would receive at the end of the Army Contract, much as a down payment from the vendee to the vendor might be repaid by being credited against future billings. Judge Knapp found that Leonard's representations to the contrary fraudulently induced Teledyne to enter into the Subcontract in reliance on the supposed sufficiency of future Army Payments to satisfy payments to be due it from Eon under the Subcontract (A39).

** Kearns Manufacturing Corporation, against whom Teledyne voluntarily discontinued its action prior to trial, was at all relevant times a substantial Eon shareholder and an affiliate of Srybnik (who controlled its board and voted its Eon stock) (A700-01).

In its second claim, Teledyne averred that Eon, with the knowledge, consent and participation of appellants, knowingly appropriated Army Payments from the Special Account for purposes other than to pay Teledyne, thus breaching a fiduciary duty owed Teledyne and converting property in which the latter had a special interest.

The proceedings below

Appellants moved before Judge Bauman, subsequent to the completion of discovery but prior to trial, for summary judgment dismissing the complaint for failure to state a claim for relief against them as individuals, while at the same time acknowledging the validity of Teledyne's claim against Eon. After reviewing voluminous documents and deposition transcripts, Judge Bauman denied their motion. 373 F.Supp. 191 (S.D.N.Y. 1974) (A1200). Judge Bauman's opinion served not only to clarify the law applicable to the issues to be tried, but also constituted an explicit "roadmap" to the items of proof which he contemplated would be relevant to a determination thereof.

Following Judge Bauman's retirement from the bench, the case went to trial for 12 days before Judge Knapp, to whom it had been reassigned, sitting without a jury. Judge Knapp's decision after trial (401 F.Supp. 729 (S.D.N.Y. 1975)) (A25) concurred completely with Judge Bauman's interpretation of applicable law and, in addition, no doubt aided by Judge Bauman's earlier "roadmaps," applied such law to the evidence adduced by the parties at trial.* Judge Knapp awarded Teledyne judgment on its second claim, holding that appellants had wrongfully appropriated and converted the final two Army Payments totalling $297,448.90 from the Special Account.

While appellee obviously does not contend that the resulting judgment is *ipso facto* unreviewable, the fact is that appellate courts are rarely given the benefit of two

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* Obviously, Judge Knapp—unlike Judge Bauman—was able as well to observe and evaluate the witnesses' demeanor on the stand.

such comprehensive and carefully considered opinions as those fashioned below; likewise, respective counsel at trial had themselves benefited from the extraordinary degree of pre-trial focusing of issues, which in turn led to a clear and orderly presentation of evidence and development of the facts.

Statement of the facts relevant to the issues presented for review

Because appellants' brief preferred the convenience of *ipse dixit* to a careful review of the record, a somewhat more disciplined analysis of the evidence before the District Court must be undertaken. Minor points, internal inconsistencies and obvious mistakes in appellants' logic or summary of facts have been bypassed in favor of an examination of what appear to be their least frivolous contentions.

1. The purpose of the Special Account.

Referring to Leonard's October 11, 1971 letter to Homer Coleman ("Coleman"), one of Teledyne's negotiators, Judge Bauman's opinion denying summary judgment forecast the issues to be resolved at trial:

> "In closing, Leonard states: 'We will pay you as we agreed and you have the largest bank in California acting as monitor in your behalf.' *Plaintiff may legitimately question what monitoring function was performed if the account was administered in the manner in which the Eon executives have explained it here.* Defendants' version also leaves unexplained the question of why Rouse and Coleman, obviously concerned with the certainty of Eon's payments under the subcontract, would have accepted a 'special account' arrangement which provided no security whatsoever. Further explication of the meaning of the special account provisions must therefore abide the trial." (373 F.Supp. at 200) (A1215)*

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* Unless otherwise noted herein, all emphasis has been supplied.

At trial, literally all of the testimony pointed to Teledyne's version. As Judge Knapp stated in his opinion:

> "There can be little doubt after considering the testimony adduced at trial that the evidence convincingly supports plaintiff's version of the intended purpose of the special account arrangement. To put it quite bluntly, no other explanation makes any sense whatsoever." (401 F.Supp. at 740) (A46)

a. Teledyne's knowledge of Eon's precarious financial straits.

Harold Rouse ("Rouse"), Teledyne's Vice-President for Operations, returned a call, received by Teledyne at its Muskegon, Michigan offices on May 7, 1971, from a Gene Walper ("Walper"), a business broker, who asked Rouse if Teledyne were interested in a subcontract to manufacture approximately 4,400 generator sets. In order to protect his commission, Walper stated that he would not reveal at that time the name of the prime contractor (A77). Rouse, after expressing interest, contacted Coleman, the plant manager of Teledyne's generator set manufacturing facility in South Carolina, and the two journeyed to California on Sunday, May 9th. Not until the following morning when Walper introduced them to Leonard were they aware that the prime contractor was Eon.

During the course of their opening negotiations that day, Rouse called his office to inquire as to Eon's creditworthiness. Both Rouse and Coleman testified that Rouse was telephoned later that day by his office and informed that Eon Corporation had a very bad Dun & Bradstreet report (A104, 405). The suggestion was made by Rouse's office that he and Leonard find some means—such as a novation or a special bank account—whereby Teledyne could assure itself of payment directly from the government (A104, 406), thereby assuring Teledyne of payment on the Subcontract. Compelling one of these two alternatives was their assumption, expressly confirmed to them by Leonard, that Eon's financial situation was such that Teledyne could only get paid out of the Army Payments

(A531-32). Indeed, Leonard testified that he "advised Mr. Coleman and Mr. Rouse of the fact that American Marc had no money from which to pay except from progress payments received from the Government" (A732) and immediately thereafter admitted that "this Bank of America arrangement was the result of those discussions" (A733).

Anton, who had been sent to close the Subcontract arrangements by the other appellant directors (A615), due to its importance to Eon, concurred that it was his understanding at the time that the Army Payments were "the only funds we could have paid them [Teledyne] from" (A663) and that Eon lacked any other source of paying Teledyne (A807). While they were alone prior to Anton's meeting the Teledyne representatives, Leonard told Anton that he had informed Teledyne that Eon's financial condition was "tight" (A802-03, 808-09). When Anton joined the meeting, he recalls Rouse telling him that he had already discussed with Leonard and "was aware of the financial conditions of American Marc" (A962-63).

To avoid the admitted problem of Eon's lack of creditworthiness, Rouse first suggested that the Army Contract be "novated", that is, that Teledyne be substituted as contractor in place of Eon (A98-99, 105, 402). Leonard corroborated this testimony, stating that he rejected a suggested novation because (1) it would be time-consuming and (2) it would cause Eon to lose its profit (A727-28). Ultimately, even Anton could not dispute that Teledyne initially requested such a novation (Tr1715).*

In short, the testimony completely fails to reveal any other source from which it was contemplated that Teledyne could be paid under the Subcontract. Consequently the conclusions are inescapable (1) that both Rouse and Coleman believed—and manifested their belief—that the Army Payments were the sole source from which Teledyne could be paid under the Subcontract, (2) that such belief

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* "Tr" references are to pages of the trial transcript contained in the record on appeal.

prompted a discussion concerning the manner in which Teledyne could be assured that the Army Payments would be paid to it, and (3) that this in turn initiated discussion of the "Special Account" arrangement.

b. The agreement was for a Special Account which would so closely "associate" and "identify" Teledyne with the Army Payments as to constitute a virtual ownership interest.

Since Leonard would not consent to a novation (A98-100, 727), Rouse mentioned the other alternative suggested to him by Muskegon—a "special account." At first there was a discussion of setting up an actual Teledyne bank account into which the Army Payments could be placed directly. However, it was concluded that the government, since it would not be contracting directly with Teledyne, would not allow the Army Payments to be deposited in such an account (A409-10). Also, since Eon would not disclose the price per unit it was getting (A94-97) or allow Teledyne to prepare the pricing terms of Eon's billings under the Army Contract (A448, 450-51), neither Teledyne nor the Bank of America (but only Eon) would know which portion of the funds to be received from the U.S. Army would correspond to Teledyne's invoices to Eon, and thus would constitute Army Payments. In order to accomplish virtually the same result, it was concluded that Eon would set up an American Marc "special account" at the Bank of America into which the Army Payments would be deposited and from which, pursuant to appropriate instructions from Eon, Teledyne would immediately be paid (A409-10) (the "Special Account"). On the evening of May 10, 1971, Rouse spoke to Earl Kotts ("Kotts"), Teledyne's attorney in Detroit,* who told him that a "special account" would be acceptable, provided Eon would agree it could not be used to pay others (A553).

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* Teledyne's Continental Motors Division, headquartered in Michigan, did not have a staff attorney in California. Rouse's sole legal "clearance" for entering into the Subcontract was therefore obtained from Kotts in Michigan over the telephone (A576).

According to Leonard's testimony, on May 11 Rouse came back with a specific list of things he wanted, which included "the banking arrangement" (A729). Leonard indicated to him that this would be acceptable, and mentioned the Bank of America (A408). As Leonard explained it in his own words:

> "I think previously we discussed [that] this D&B report on Eon indicated to Teledyne that to the best of their abilities they should try *to associate themselves as closely as possible,* I guess, with the government funds that were available on the contract." (A 762)
>
> * * *
>
> "[T]he checks when they came in were to be deposited. Those were then *to be identified with invoices that were outstanding from Teledyne* and the payments would be made in accordance with those amounts that were due to Teledyne out of that account." (A 736)

It is noteworthy that Leonard described Rouse as attempting to "associate" and "identify" Teledyne "as closely as possible . . . with the government funds" by having Eon set up a bank account whose contents would be treated as Teledyne money temporarily handled on its behalf by Eon. As explained by Rouse, the banking arrangement contemplated "a special bank account being set up for the money that would flow from the second year procurement, *which would be our own money,* and we would be paid from the special account" (A222).

Nor did Teledyne learn that Eon claimed otherwise until the present litigation. In a meeting called in June of 1972 by Coleman to check the status of Army Payments, among the questions put to Anton by Kotts and Coleman was: where was "Teledyne's money" (A569) which was supposed to be in the account and which "belonged to" Teledyne (A568)? Anton did not challenge the assumptions implicit in this question, but rather acknowledged their validity and lamely indicated that "he was sorry about it" (A569). Clearly Rouse, Coleman, Leonard and Anton *all* considered the Special Account to be the mechanism through

which Teledyne, as Leonard phrased it, would have the close "association" and "identification" with the Army Payments.

2. The Special Account created a fiduciary relationship between the parties and gave Teledyne a "special interest" in the Army Payments therein.

Judge Bauman's opinion set forth the factual criterion applicable to the Special Account which, if established at trial, he indicated would prove the existence of a fiduciary relationship between Eon and Teledyne, and therefore a breach of trust:

> "Under plaintiff's theory, the progress payments were to be segregated in a special fund the principal purpose of which was the payment of Teledyne's invoices. If plaintiff can sustain this theory at trial, it will have adequately demonstrated the existence of a fiduciary relationship." (373 F.Supp. at 202) (A1219)

Judge Bauman framed in similar terms the issues of fact upon which would turn the cause of action in conversion:

> "Whether or not Teledyne possessed such a special interest [in the Army Payments] here depends, in turn, on my ultimate determination of the function and purpose of the special account. If the account was to be maintained as plaintiff contends, it would appear that Teledyne possesses a special interest, short of actual ownership, sufficient to maintain an action for conversion." (373 F.Supp. at 202) (A1221)

Judge Knapp concluded after trial that there was "little doubt . . . that the evidence *convincingly* supports plaintiff's version" of the Special Account (401 F.Supp at 740) (A46).

While the mechanics of the Special Account contemplated that Eon would deposit all receipts under the Army Contract and identify the Army Payments, its use of the latter would be restricted to the payment of Teledyne invoices only; any balance of funds remaining in the Special Account after Teledyne had first been paid (*i.e.*, Eon's profit margin) would then be freed for Eon's other use. The

following five documents, each bearing the signature of an Eon representative, set forth the parties' formal agreement as to the nature and mechanics of the Special Account arrangement:

(1) Rouse's May 13, 1971 letter to Leonard, a copy of which was "acknowledged and accepted" by Leonard on May 25, 1971 (A 1108);

(2) Leonard's May 25, 1971 letter to the Palos Verdes Branch of the Bank of America referring to the Teledyne Subcontract and "our special account which we have opened at the Bank of America *for this purpose*" (A 1113);

(3) Leonard's May 25, 1971 letter to Coleman referring to the special account "which will be used to pay TCM [Teledyne] invoices" (A 1110);

(4) Leonard's October 11, 1971 letter to Coleman stating that you have "the largest bank in California acting as a monitor in your behalf " (A1115); and

(5) Modification No. 9 to the Subcontract (A 1101).

In addition, Rouse's handwritten notes of the items covered with Leonard and Anton at their May 12 meeting (A1089), a photocopy of which was left with Eon (A132, 140) and turned up in Eon's files in New York (A 136), states in pertinent part:

> "Meeting May 12—1971
> The following items were agreed to:
>
> 1. Eon will set up with Bank America to hold funds received from Generator sales to the Government for a special account and will pay invoices to TCM [Teledyne] *before anyone else.*" (A1089, 139)

Appellants cannot dispute the accuracy of these documents. In addition, Judge Knapp also properly took into consideration notes taken by Rouse in his "Daytimer" contemporaneously with the May 10-12 negotiations, as well as oral testimony concerning the discussions culminating in the Special Account arrangement.

Both Rouse and Coleman testified that they had made an agreement with Leonard, later specifically approved by Anton, which would restrict Eon's use of the Army Payments (A106-07, 262-63, 475-76). Supporting their recollections are contemporaneous notes prepared by Rouse, such as those contained in his "Daytimer" notebook (A1087):

> "(2) Will set up with bank to dispurse [sic] the funds. Jim [Leonard] will send a letter confirming that it is set up with Bank America to *pay us first.*"*

Leonard himself, although reluctant to admit directly that such a restriction was contemplated, described the various Special Account documents signed by him as meaning:

> ". . . that we have an account where the moneys would be deposited and that we would direct that the moneys be paid out of that account.
> Q To Teledyne?
> A Yes." (A734-35)**

Indeed, Leonard actually characterized the later decision of the appellant directors to utilize the Army Payments other than to pay Teledyne as meaning "that they were not going to disburse the funds *in accordance with the agreement*" (A743).

Nor did Anton, when later confronted by Teledyne, deny that the appellant directors had violated the Special Ac-

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* This entry, since it was part of his "to do" list, was crossed out by Rouse after he received Leonard's May 25, 1971 confirmations of the Special Account arrangements (A212-14).

** This question and answer are omitted, not surprisingly, from the lengthy quotation from Leonard's deposition in Appellants' Brief (hereinafter abbreviated "Br."), at 7-9. Appellants describe Leonard as "Teledyne's own witness" (Br., 7), which is clearly inaccurate since Leonard was, at the time of the events in question here, an officer and director of Eon. Moreover, his deposition, taken pursuant to subpoena caused to be issued by Teledyne, evidences a clear hostility to it and (unsuccessful) attempts to help appellants. In any event, appellants cannot merely claim that Leonard was Teledyne's witness and then ignore—as they try to do—those portions of his testimony unfavorable to them.

count agreement. Neither in his June 29, 1972 meeting with Coleman and Kotts nor in his July 17, 1972 meeting with Jonathan Bank ("Bank") and Spencer Letts ("Letts"), Teledyne's corporate counsel, did Anton contest Teledyne's charge that appellants' actions constituted a wrongful diversion of funds held in trust for Teledyne (A588-89, 592, 599). While he claimed not to recall any discussion of the Special Account on May 12, 1971, incredible testimony specifically refuted by Leonard (A736-37) and disbelieved by Judge Knapp (A48, 906-07), Anton nevertheless did admit that, *had* such a trust fund arrangement indeed been proposed by the Teledyne representatives, he would have gone along with it without objection (A1076).* Indeed, he testified that he would even have assigned the Army Payments themselves, assuming that this were possible (Tr2186).

3. Appellants' proposed alternative interpretations of the Special Account are inconsistent with their own testimony and do not make "any sense whatsoever."

During the course of the trial appellants, while denying Teledyne's interpretation of the Special Account, proposed various alternative theories of their own to explain why the parties contemplated a relationship less than fiduciary in nature. These attempts were no doubt stimulated by Judge Bauman's "roadmap" and Judge Knapp's observations to counsel during trial that the purpose ascribed to the Special Account by Rouse and Coleman seemed to be consistent both with the documents and with their overall testimony. Judge Knapp asked that appellants present an equally credible contrary explanation, but was met only with the following alternative suppositions which simply didn't make "any sense whatsoever" (A46):

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* This admission totally undercuts appellants' position on their companion appeal seeking a new trial based on "newly discovered" evidence, which, in effect, nonsensically accuses Teledyne of having to go behind Anton's back to obtain the Special Account, a feat supposedly accomplished by a "kickback" to Leonard through Walper.

a. As a means of avoiding attachment by other creditors.

Anton first testified that the purpose of the Bank of America account, as he understood it, was to "hide" the Army Payments and prevent other creditors from attaching the money (A814).* However, both Rouse and Coleman denied any discussion whatsoever of attachments or the use of a bank account to prevent attachments during the entire negotiations (A378-79, 409). Indeed, Anton himself elsewhere conceded that there was no such discussion in his presence (A1038).

b. As a means of drawing cashier's checks.

Appellants' counsel during trial argued that the Special Account was to serve the sole function of paying Teledyne by cashier's check.** As pointed out by the Court, however, it would have been totally irrational for Rouse and Coleman, aware as they were of Eon's "tight" financial position, to be concerned merely about the *type* of check (*e.g.*, corporate or cashier's) if they had no assurance that the funds themselves would be available with which Eon could even purchase a cashier's check in the first place. Anton further destroyed this theory by admitting that there had been in fact no discussion in his presence concerning the use of cashier's checks (A1036-38).

c. As a continuation of an earlier account set up for other suppliers.

Anton similarly conceded that no discussion was had in his presence concerning the use of a pre-existing bank account to handle the Teledyne payments (A814, 1038). To the contrary, both Rouse and Coleman testified that a *new* account was *to be set up* specifically for Teledyne (A156, 406), a fact which is corroborated by Rouse's

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* If this "interpretation" were correct, it would certainly indicate, contrary to Anton's other testimony (A810), that Rouse and Coleman were concerned over Eon's solvency and ability to pay.

** Counsel could not explain why a separate bank account had to be used in order for Teledyne to be paid by cashier's check.

"Daytimer" (A1087) and his handwritten notes (A1089). Indeed, Leonard's May 25 letter (A1113) clearly implies the creation of a new account, a fact that was further confirmed both by Leonard's October 11 letter (A1115) and Modification 9 to the Subcontract (A1101-02).

d. As a means of describing the time at which payment was to be made to Teledyne.

Anton then attempted to explain the Special Account as a mere "payment due" term, by means of which Teledyne was to be assured that it would be paid as soon as Eon had received the Army Payments from the government. In his trial testimony, he vividly recollected on first seeing the Subcontract at the American Marc offices noticing that it had a "net 30 days" term on it (A1091-1100). His initial reaction was immediately to complain to Rouse that this would be impossible "because we do not have the funds", to which Rouse replied that the term appeared on the purchase order only "for his internal purposes", and that "if you can't pay in 30 days, so you'll owe me" (Tr1148-49). But when earlier asked to describe that meeting at his deposition, however, Anton completely omitted any reference to a discussion of the "net 30 days" payment provision (Tr600-02), suggesting that this "explanation" may have been contrived after the fact.

But even assuming such discussions were had, that would not be at all inconsistent with Teledyne's understanding of the Special Account. In fact, Anton's objection to these terms contains an explicit admission that Eon had no funds other than the Army Payments from which it could pay Teledyne, hardly raising the inference that Rouse and Coleman merely would have been worried about the *time* of payment, rather than the *likelihood* of ever receiving any payment at all. When asked how he could explain such an oversight on the part of Rouse and Coleman, Anton could only suggest they must have had no concern whatsoever about Eon's ability to pay:

"THE COURT: You thought they [Rouse and Coleman] didn't care if they got paid or not, in substance?

THE WITNESS: Well, I won't put it that way. I would imagine they were thinking *when* they would get paid, whether it was 30 days or 45 days or 60 days.

THE COURT: Don't you think they were thinking about *whether* they would get paid?

THE WITNESS: If they did they would have said so. *They would have put some conditions,* they would have said something. They were absolutely mute." (A810)

What is plainly apparent is that Rouse and Coleman *did* "put some conditions" on payment, and those conditions were all directed to assuring that the Army Payments would, via the "monitoring" of the Special Account and Eon's safekeeping of the funds within it, be restricted in the first instance to the payment of Teledyne invoices (A1115-16).

e. As a method of "observing" and "reporting" to Teledyne.

Apparently, none of the four preceding explanations offered at trial is now being pressed on appeal, since not argued in appellants' brief. However, a fifth theory now appears to have been discovered on appeal—that the Special Account arrangement "meant simply that the bank would observe when the progress payments were deposited . . . and report its observations to Teledyne" (Br., 18-19). To proffer such a theory seriously at this juncture is to demonstrate total disregard for the trial record.

First, it overlooks the fact that the Bank of America's depository relationship encompassed sending its account statements and deposit receipts to Eon—not to Teledyne (A1122-32). No reports were ever given by the bank to Teledyne, and the record is devoid of evidence of any such expectation on Teledyne's part.*

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* Otherwise, Teledyne would have complained that it wasn't getting the "reports" or "observations" that it expected. Such a complaint was never made.

Second, without a requirement that reports be sent to Teledyne, mere "observation" by the bank (whatever that would mean) would serve no conceivable purpose, and certainly would not have required a separate bank account.

Third, such an arrangement could in no way have overcome the concern over Eon's ability to pay which Rouse and Coleman had expressed during the Subcontract negotiations, nor indeed been consistent with any of the documents or contemporaneous notes referring to the Special Account.

4. Appellants' misappropriation of the Army Payments in violation of the Special Account arrangement.

a. The misappropriation.

Appellants do not here take issue with Judge Knapp's finding (A48) that "there is no dispute that the four defendants authorized and did use the funds in the special account for purposes other than the payment of Teledyne invoices." (Br., 5A, 25, 30). Accordingly, their intentional participation in Eon's misappropriation of $297,448.90 in Army Payments from the Special Account remains uncontested. What appellants do dispute, however, is Judge Knapp's finding that they authorized, ratified or participated in such misappropriation with knowledge of the existence of restrictions on Eon's use of funds in the Special Account.*

b. Appellants' knowledge that Eon's use of Army Payments was in violation of Eon's Special Account arrangement with Teledyne.

Rouse's handwritten notes (A1089-90), which include a description of his understanding of the Special Account, were found in and produced from Eon's "New York" files

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* Judge Knapp, agreeing with Judge Bauman, found that appellants' actual knowledge *vel non* of these restrictions was superfluous, since under well-established California law appellants' state of knowledge was irrelevant (*see* discussion *infra*, at 40-42).

(A132-33). Rouse testified that the Special Account arrangement was one of the items reviewed on May 12 with Anton. Leonard, when questioned about the Special Account arrangement, initially testified that he had discussed such an arrangement with "the Board," but later caught himself and amended his statement to mean Anton. However, he testified that the board members "all were familiar with the agreement and what you fellows [Teledyne] had requested . . ." (A736). Leonard in fact had attended Eon board meetings in New York, where he brought the other directors current on the Subcontract (A734, 751-52, 799, 1352-54).

Anton indicated that all of the other appellant board members at least knew that some sort of special account, used to pay Eon's suppliers existed, and that he had discussed such an account with Waller, Podell and Srybnik (A648). Srybnik testified that he was informed by Anton that Teledyne was relying on the Army Payments and that Teledyne "was getting paid the same way that American Marc was being paid . . . the government paid American Marc, and American Marc would pay Teledyne" (A713).

Srybnik professed at trial that he had not even been aware of the Special Account through July 18, 1972, the date of his meeting with Messrs. Bank and Letts. When confronted with his deposition testimony, wherein he stated that the Special Account was brought up by Letts at that meeting, Srybnik could not explain the discrepancy (A866-68). And while Srybnik testified that Letts at that meeting indicated that Teledyne intended to hold him personally liable for Eon's appropriation of the Army Payments, and while as a sophisticated businessman he was well aware of the general rule that a corporate director is not liable for debts of the corporation, Srybnik conceded that he did not even question Letts as to the asserted basis of his personal liability (A882-83).* Obviously he did not have to question, since he was well aware of it.

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* Judge Knapp expressed particular disbelief at this testimony (A882-83).

Anton, who testified that he had been "aware of the method of payment to Teledyne out of the funds that were received" (A628-30), acknowledged that portions of the Army Payments were intentionally diverted for purposes of satisfying more pressing obligations of Eon to keep it from going "busted" (A599, 647, 663). Leonard testified that in May of 1972, as the result of a decision made in New York (A739), Eon instructed the Bank of America "not . . . to pay those TCM [Teledyne] invoices" (A738-39). Leonard subsequently learned—and informed Srybnik (A1352-54)—that Anton caused a Special Account check supposed to be used to purchase a cashier's check payable to Teledyne (A1004-05) in the amount of $216,000, which Leonard had prepared for signature, not to be issued (A739, 1352-54). These Army Payments were instead withdrawn from the Special Account and redeposited in Eon's Bankers Trust account in New York (A1475). In addition, the final Army Payment of $81,448.90, as reflected in Advice of Payment (DSA477) No. 60 (A1622), was similarly withheld and deposited in the Bankers Trust account (A1476). All in all, Anton told Teledyne that checks totaling approximately $300,000 identified for payment of Teledyne invoices were used "for payment of other creditors of Eon Corporation" (A593-94, 823). Anton confirmed that the entire board—which included all appellants—had participated in these decisions (A469-70, 560-61, 593-94, 647).

When questioned by Kotts at the June 29 meeting, Anton acknowledged that he was "sorry" about this and that he recognized that the funds should have been used to pay Teledyne (A585-89). A similar confession was made by him at the July 17 meeting, at which Leonard and Podell were also present (A591-92). While Anton was unable to state at the latter meeting exactly what had been done with the money, he referred the Teledyne representatives for an explanation, to Waller, who would know the answer as the "financial man who handled the financial matters for Eon" (A595).

Rouse testified that he specifically recalled having reviewed the Special Account arrangement with Anton on

May 12, and that "we went through it from the handwritten notes [A1089] that I had, which also showed about the special bank account, how it would be set up" (A131). According to Rouse's testimony, both Leonard and Anton confirmed the items in his notes with him (A138, 212-13, 238, 422):

> "We spent some time with Mr. Anton discussing with him our concern about getting payment. . . . And we talked to him about *setting up the new special bank account* and that we wanted to be sure that they understood that the money that would be coming from the government, the second year procurement, *belonged to* [*Teledyne*] *Continental Motors* and we should be paid from that account, and also that if there was any residual money, then that would revert back to Eon. We wanted to be sure that Mr. Anton knew this, being the President of Eon. . . . *Mr. Anton agreed, and he so instructed Mr. Leonard to go ahead and set up a special bank account.*" (A239-40)

This was corroborated by Coleman (A480).*

Leonard also unequivocally confirmed that he had discussed the Special Account arrangement with Anton on the telephone in advance of his trip, and once again in California on May 12, and that Anton had agreed that under the circumstances Teledyne's request was "reasonable" (A736-37).

Similarly, with regard to Rouse's May 13, 1971 letter to Leonard (A1108), Anton had testified on his deposition that this letter "is part of our [Eon's] file" (A818). And Leonard's May 25 letter to the Bank of America was likewise acknowledged by Anton as being part of Eon's "office copy filed" (A1035), presumably received by Anton "a few days after the signing" (*Ibid.*). Trial Exhibit # 51 (A1136-85), which contained certain stapled-together documents labelled at the top "Agreement, Teledyne Industries,

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* At the time of his trial testimony, Coleman was no longer a Teledyne employee (A357), and had no interest whatsoever in the outcome of this matter.

Inc.," was obtained from Eon's New York files. Contained therein were various documents relating to the Special Account: Leonard's May 25 letter to the Bank of America (A1154), Leonard's October 11 letter (A1158-60), and Modification 9 to the Subcontract (A1161-62).*

Leonard testified that in June he attended a meeting in New York along with Anton, Srybnik and possibly others. The meeting "centered itself around the fact that there were checks deposited and there were amounts due to Teledyne and what was going to be done about this" (A755). It that meeting "all the ramifications of the situation were discussed" (A756).

On June 21, 1972, shortly after this meeting, Leonard wrote a letter directly to Srybnik in which he pointed out that Anton had diverted one of the two April checks from going to Teledyne (A1352-54). The tone of the letter clearly implied that Anton had done something wrong, a point underscored by the fact that Leonard wrote directly to Srybnik, rather than circulating a "Newsletter" to all the appellant board members as was his usual practice (*e.g.*, A1355-58, 1361-62). At trial, Srybnik first tried to deny any knowledge of this letter (A850, Tr1403) or even of discussing its contents with Anton or with Leonard (A857-58).

This was directly refuted by Anton, who testified that he had either sent the letter immediately to Srybnik, or had first telephoned him concerning its contents and then forwarded it to him (A1060). Likewise, Leonard testified that he had telephoned Srybnik on or around June 21, 1972, for the express purpose of informing him of Anton's withholding the Army Payments from Teledyne (A754). Leonard further testified that Srybnik told him in that telephone conversation that *he was aware* that the check to Teledyne had been stopped (A754).

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* The existence of these Special Account documents in New York in the "Eon office file" (A1022), in conjunction with Leonard's specific recollection of discussions with him, completely destroyed Anton's pretended ignorance of this topic and dealt a fatal blow to any lingering credibility he might have had as a witness.

Faced with this contradictory testimony, Srybnik retreated from his earlier unequivocal denial and ventured that Anton "might have talked to me on the telephone [about the letter] . . . told me what was in this letter . . ." (A854-55). When prodded still further by being shown his deposition testimony, wherein he had stated that Anton "called me, told me what was in this letter . . . and then he mailed me a copy of it" (A855), Srybnik's facade crumbled (A860-62), and he admitted that he had in fact discussed this letter with Anton and that he eventually did receive a copy of the letter sometime after Anton had received it (A864).

Weighing the forthright and "wholly credible" testimony of Rouse and Coleman (A44) against the credibility of Anton and Srybnik which "did leave much to be desired" (A43, 1078), under no circumstances could Judge Knapp's finding that Anton and Srybnik were aware of the Special Account arrangement at the time the Army Payments were appropriated be held "clearly erroneous." To the contrary, the trial record literally compels such a finding.

POINT I

The District Court, relying in large part on the credibility of the parties' respective witnesses, correctly found (1) that the clearly intended purpose of the Special Account was to afford Teledyne assurance of future payment by restricting Eon's use of the Army Payments to, in the first instance, payment of Teledyne's invoices and (2) that Teledyne had a "special interest" in the Army Payments, when received by Eon, sufficient to sustain an action for conversion.

Judge Knapp specifically found Rouse and Coleman, Teledyne's principal witnesses, "to be truthful and credible witnesses" (A39). As to appellant Anton, Judge Knapp conversely found "his credibility as a witness did leave much to be desired" (A43). Although not expressed as a finding, Judge Knapp also commented adversely on the

credibility of Srybnik, the only other appellant to testify at trial (A1078-79). With these demeanor observations to guide the District Court, Judge Knapp concluded:

> "There can be little doubt after considering the testimony adduced at trial that the evidence *convincingly supports* plaintiff's version of the intended purpose of the special account arrangement. *To put it quite bluntly, no other explanation makes any sense whatsoever.*" (A46)

It is beyond peradventure that when such a finding of fact as above is made, it may not be set aside

> ". . . unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses." *Fed. R. Civ. P.* 52(a).

Judge Knapp's findings (1) that the Special Account's purpose was, as argued by Teledyne,

> ". . . to inexorably link the Army's payment to Eon to Eon's payment of Teledyne invoices" (A46)

and (2) that Rouse and Coleman, knowing of Eon's precarious financial position (A46), insisted that

> "It was therefore critical that Eon agree to pay Teledyne invoices *first* out of the funds deposited in this account" (A46),

were both based in large measure on the credibility of Rouse and Coleman and the incredibility of appellants' testimony at trial.* These findings may be disturbed "only in the most unusual circumstances." *Orvis* v. *Higgins,* 180 F.2d 537, 540 (2d Cir.), *cert. denied,* 340 U.S. 810 (1950).**

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* Judge Knapp also relied on contemporaneous written memoranda (A47, 1089, 1108-17) and admissions of appellants (A648, 712-13, 818, 1022, 1035) which corroborated the Rouse and Coleman testimony concerning the Special Account.

** Confirming the correctness of these findings, Judge Bauman observed that:

> "Defendants' [appellants'] position, then, is that the testi-

(footnote continued on the following page)

No such "unusual circumstances" are shown by appellants.

A. Two District Court Judges Have Independently Found That The Special Account, As Intended By Teledyne To Operate, Would Create A Sufficient Special Interest Of Teledyne In The Army Payments To Sustain A Conversion Action.

Judge Bauman initially analyzed the proof necessary for Teledyne to sustain a conversion action under California law:

> "[A]n action may be brought by a person who, although not in possession, had a special interest in the property giving him a right to possession at the time of the conversion. *Pope* v. *National Aero Finance Co.*, 46 Cal. Rptr. 233 (Dist.Ct.App. 1965); *Carvell* v. *Weaver*, 54 Cal. App. 734, 202 P. 897 (Dist.Ct.App. 1921). Whether or not Teledyne possessed such a special interest here depends, in turn, on my ultimate determination of the function and purpose of the special account. If the account was to be maintained as plaintiff contends, it would appear that Teledyne possesses a special interest, short of actual ownership, sufficient to maintain an action for conversion. [citing authorities.]" (373 F.Supp. at 202) (A1221)

Judge Knapp, after reviewing and concurring in Judge Bauman's analysis of applicable California law, utilized these very guidelines in finding that Teledyne's proof of the function and purpose of the "special account" had

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(footnote continued from preceding page)

> mony of various Eon officers establishes that there was never any intention of giving Teledyne's invoices preference. . . . Defendants' version . . . leaves unexplained the question of why Rouse and Coleman, obviously concerned with the certainty of Eon's payments under the subcontract, would have accepted a 'special account' arrangement which provided no security whatsoever. Further explication of the meaning of the special account provisions must therefore abide the trial." (373 F.Supp. at 200) (A1215)

established a "special interest":

> "The plaintiff contends that Eon agreed to deposit all government payments in this account, and agreed that no monies would be withdrawn until Teledyne's invoices were paid in full. . . . If the plaintiff is successful on this issue, it seems clear that this would demonstrate the requisite special interest sufficient to maintain an action for conversion." (401 F.Supp. at 740) (A45-46)

As correctly stated by both Judges Bauman and Knapp (A1221, 45), a conversion action is maintainable where plaintiff proves that he has some form of interest in certain property, not outright possessory, but nevertheless "giving him *a right to possession* at the time of the conversion." *Pope* v. *National Aero Finance Co.*, 236 Cal. App.2d 722, 46 Cal. Rptr. 233, 239 (1st Dist. Ct. App. 1965).*

While appellants concede that the "special interest" rule is supported by "numerous cases" (Br., 20), their confused argument, when analyzed, does not address this doctrine. Thus, appellants attempt to argue that a "special interest" can *only* be found in those instances wh plaintiff "at one time exercised *direct control* over the chattel through ownership [or] *possession*" (Br., 21). If, by "at one time", appellants mean *prior* to the conversion, then their argument necessarily fails since the touchstone of the "special interest" rule is whether there was a "right to possession *at the time of the conversion.* If, by "at one time", appellants mean that plaintiff "exercised direct control . . . through ownership [or] possession" at the time of the conversion, their argument is equally flawed for the "special

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* Appellants' reliance on *Pope* (Br., 22-3) is wholly misplaced, for *Pope* merely held that purchasers of stock in a flying club which leased an airplane from the record owner of the plane did not have any ownership or special possessory interest in the plane. It was further specifically found that plaintiffs "were fully aware of the fact that they had no ownership or special possessory interest in the plane". 46 Cal. Rptr. at 239. In the case at bar, conversely, Teledyne at all times had—and believed it had—a "special possessory interest" in the Army Payments (*see* discussion, *supra*, at 10-12).

interest" rule only applies when there was *no* such *direct control* at the time of the conversion, but rather there existed a right to possession.

Moreover, the case law does not suport appellants' position. For example, in *California Cured Fruit Ass'n* v. *Ainsworth,* 134 Cal. 461, 66 P.586 (1901), plaintiff, who had a limited percentage interest—by contract—in crops, was held nevertheless to have a "special interest" therein, even through defendant was the sole owner of the land and plaintiff had *never* exercised any direct control over either the land or the crops. Similarly, in *Mathew* v. *Mathew,* 138 Cal. 334, 71 P.344 (1903), it was held that a chattel mortgagee had a "special interest" in personal property although at all times the mortgagor had been the owner with possession thereof.

Additionally, the "special interest" rule is one of broad application. *Camp* v. *Ortega,* 209 Cal. App. 2d 275, 25 Cal. Rptr. 873. 879-80 (1st Dist. Ct. App. 1962) (cited by Judge Bauman (373 F.Supp. at 202) (A1221)).*

B. The Special Account Arrangement Operated As An Equitable Assignment Of The Portion Of The Army Payments Representing Teledyne's Invoices And By Virtue Of That Fact Alone Created A Sufficient Special Interest.

Judge Knapp found that:

> "Rouse and Coleman both were concerned over Eon's ability to meet its financial obligations under the proposed subcontract. They both knew that Eon's only source of income were the *funds* available under the Army contract, which they then thought were sufficient to meet Eon's obligations to Teledyne. The sole purpose in suggesting the special account was to *inexorably link the Army's payment to Eon to Eon's payment of Teledyne invoices. It was therefore critical that Eon agree to pay Teledyne invoices first out of*

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* As to other forms the interest may take, *see California Cured Fruit Ass'n* v. *Ainsworth* and *Mathew* v. *Mathew, supra.*

the funds deposited in this account." (401 F.Supp. at 740-41) (A46)*

Judge Knapp further found that the documentary evidence supported this conclusion (A47). These findings, then, invoke ready application of the settled doctrine of equity

> ". . . that every express executory agreement in writing, whereby the contracting party sufficiently indicates an intention to make some particular property, real or personal, *or fund*, therein described or identified, *a security for a debt or other obligation, or whereby the party promises to convey or assign or transfer the property* [*fund*] *as security, creates an equitable lien upon the property so indicated* . . . Under like circumstances, a merely verbal agreement may create a similar lien upon personal property." 4 Pomeroy, *Equity Jurisprudence* § 1235 (5th ed. 1941).

This principle has been liberally interpreted and consistently applied in the California courts. *See, e.g., Higgins* v. *Manson*, 126 Cal. 467, 58 P. 907, 908 (1899); *Title Ins. & Trust Co.* v. *California Devel. Co.*, 171 Cal. 173, 152 P. 542, 554 (1915).

In determining whether such an equitable charge will attach

> " '*The form of a written, equitable transfer or assignment*, based upon valuable and reasonable consideration, *is not important if the intention of the transferor is ascertainable* and the instrument is actually delivered.' (Anglo California Nat. Bank of San Francisco v. Kidd, 58 Cal. App.2d 651, 655-656, 137 P.2d 460, 463) Too, in determining whether an assignment has been made, the court may go outside the terms of the instrument and find an assignment from the conduct of the

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* Judge Bauman also so found that its conversion count would be successful if Teledyne should prove this "link" at trial (373 F.Supp. at 202) (A1221).

parties. (Long v. Thompson, 45 Cal.App.2d 161, 169, 113 P.2d 698)." *McGafferty* v. *Gilbank*, 249 Cal. App.2d 569, 57 Cal. Rptr. 695, 699 (2d Dist.Ct.App. 1967).

Accord, Held v. *Beach-Robinson Co.*, 32 Cal.App. 93, 162 P. 661, 663 (1st Dist.Ct.App. 1916).

Turning, then, to an examination of the documents and testimony, it cannot be disputed on appeal that Rouse and Coleman were concerned by Eon's precarious financial condition (A104, 405, 732, 962-63) and sought to link Eon's receipt of the Army Payments to the payment of Teledyne's invoices (A104, 222, 407, 762). When Eon announced that it could not for technical reasons novate (*i.e.*, legally assign) the Army Contract and still keep its profit on the Subcontract (A98-100, 727), the Special Account was established to accomplish the same result—that is, give Teledyne a virtual ownership interest in the Army Payments by way of the Special Account (A222).

The documents "actually delivered" establishing and interpreting the Special Account (A1101-02, 1108-09, 1110-12, 1113-14) coupled with the admissions of Eon's representatives that Teledyne contemplated being "associated" and "identified" with the Army Payments as closely as possible, virtually compels the finding of an equitable ownership interest therein on its behalf (A736, 762).

1. Cases are legion finding equitable charges where the parties' intent was less clear than in the case at bar.

Eon delivered to Teledyne a written executory promise that it would

> ". . . hold funds received from 1.5 generator sales in a special account which will be used to pay TCM invoices." (A1111)*

Judge Knapp interpreted this language, in light of all the evidence, to constitute a promise to devote such funds *ex-*

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* To like effect, *see* A1101-02, 1108, 1113.

clusively to Teledyne's use, at least until it had been fully paid under the Subcontract.

The California courts—even without reference to parol evidence—would find such a promise to have created an equitable charge. In *Held* v. *Beach-Robinson Co., supra,* the following far more limited language was held to have created an equitable assignment:

> " 'San Francisco, 1914, January 19.
>
> 'Ernest Held, Esq.—Dear Sir: We promise to pay you $630 and $150, equal to $780, out of the Grace Cathedral fund as soon as we receive it from the Grace Cathedral Association, which we expect will be about February 26, 1914. Respectfully yours, The Beach-Robinson Company, per R.E. Beach, Sec.' " 162 P. at 662.

In *Oxnard School Dist.* v. *Penn,* 132 Cal.App. 763, 23 P.2d 828 (3d Dist.Ct.App. 1933), the following sparse statement of future intent was sufficient to create an equitable assignment in favor of Peoples Lumber Co.:

> " 'October 31, 1929.
>
> 'Mr. R. B. Haydock, Oxnard, Cal.
>
> 'Dear Sir—When you secure a properly executed warrant for settlement of the balance due me on the Woodrow Wilson school job, deliver said warrant to the Peoples Lumber Co., Ventura, and I will endorse the same over to said Peoples Lumber Co. in payment for materials furnished.
>
> '[Signed] G. E. Penn.' " 23 P.2d at 829.

See also Bartlett v. *Pac. Nat'l Bank,* 110 Cal.App.2d 683, 244 P.2d 91, 92 (1st Dist.Ct.App. 1952) ("one fourth of all money recovered" deemed sufficient language); *Estate of Henshaw,* 68 Cal.App.2d 627, 157 P.2d 390, 394 (1st Dist. Ct.App. 1945) (fund "from the proceeds of said trust estate" also deemed sufficient).

2. California courts have uniformly charged progress payments in the hands of a prime contractor with equitable liens in favor of subcontractors who are relying on payment from the prime contractor out of such funds.

That Teledyne knew it could look to payment of its Subcontract invoices *only* from out of progress payments to be received by Eon from the U.S. Army is indisputable (A531-32, 732, 1115).

In such fact situations, California courts have consistently held that an equitable lien—as opposed to a statutory mechanic's lien—will be impressed in favor of subcontractors against funds which were obtained by a borrower in the form of progress payments as construction proceeded. *See, e.g., Doud Lumber Co.* v. *Guaranty Savings & Loan Ass'n,* 254 Cal.App.2d 585, 60 Cal. Rptr. 94 (1st Dist.Ct.App. 1967); *McBain* v. *Santa Clara Savings & Loan Ass'n,* 241 Cal.App.2d 829, 51 Cal. Rptr. 78 (1st Dist.Ct.App. 1966):

* * *

> "We conclude that where, as here, persons supplying labor and materials to the property have been induced by either the borrower or the lender to rely on construction loan funds for payment, it comports with justice and fair dealing that their equitable lien assertible against such funds should have priority over any claims of the borrower and the lender by whose joint agreement the construction financing was provided, implemented and carried out." 51 Cal. Rptr. at 86, 89.*

3. These equitable charges create such a possessory interest as will sustain an action in conversion.

Equitable assignment —considered tantamount to liens— will vest the assignee thereof with such an interest in the

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* This is not based on any specialized legislation or common-law rule applicable only to the construction industry, but applies with equal force to ordinary subcontracts to manufacture chattels. 4 Pomeroy, *Equity Jurisprudence* § 1234 (5th ed. 1941); *Mannon* v. *Pesula,* 59 Cal.App.2d 597, 139 P.2d 336 (1st Dist.Ct.App. 1943).

fund equitably assigned as to allow him to maintain a conversion action to recover any portion of it. *McGafferty* v. *Gilbank, supra; Hinkle Iron Co.* v. *Kohn,* 229 N.Y. 179, 183-84 (1920). *Cf. Beach* v. *Held-Robinson Co., supra.*

C. The Special Account Arrangement Constituted A Constructive Trust And, When The Appellants Diverted Funds Therefrom, A Conversion Was Effected.

With characteristic *ipse dixit,* appellants attempt to assert that, in order to have found a conversion, Judge Knapp must have found that the Special Account "established a 'trust' or 'quasi trust'" (Br., 10). Since the law is quite otherwise,* the absence of cited authority for this statement is not surprising.

There is no question in this case that Eon agreed to pay Teledyne's invoices out of (indeed *only* out of) the Army Payments (*see, e.g.,* A1113). Further, it is beyond doubt that appellants directed that the last two Army Payments be used, not for payment of Teledyne's invoices, but rather for other purposes (A647).

Under such circumstances, a constructive trust was created, with Eon as trustee and Teledyne as beneficiary.** As stated in *Weiss* v. *Marcus,* 51 Cal.App.3d 590, 124 Cal. Rptr. 297, 304 (2d Dist.Ct.App. 1975):

> "The principal constructive trust situations are set forth in two statutes. [California] Civ. Code § 2223 provides: 'One who wrongfully detains a thing is an involuntary trustee thereof, for the benefit of the owner.' Civ. Code § 2224 provides: 'One who gains a

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* *See also* Point I, A, *supra,* for the authorities establishing that an equitable assignment constitutes a sufficient "special interest" to maintain a conversion action.

** The burden of proof of a constructive trust is one of "clear and convincing evidence." *Sparks* v. *Lauritzen,* 248 Cal. App.2d 269, 56 Cal. Rptr. 370, 372 (1st Dist.Ct.App. 1967). Appellants' citation (Br., 20) of this same case for the proposition that a "trust or . . . special interest" must be proved "beyond a reasonable doubt" is, at best, a gross misstatement.

> thing by fraud, accident, mistake, undue influence, the violation of a trust, or other wrongful act, is, unless he has some other and better right thereto, an involuntary trustee of the thing gained, for the benefit of the person who would otherwise have had it.' Thus, *a constructive trust may be imposed in practically any case where there is a wrongful acquisition or detention of property to which another is entitled.* [citing authorities] 'The cause of action is not based on the establishment of a trust, but consists of the fraud, breach of fiduciary duty, or other act which entitles the plaintiff to some relief. That relief, in a proper case, may be to make the defendant a constructive trustee with a duty to transfer to the plaintiff.' (3 Witkin, Cal. Procedure, 2d ed., p. 2319, 'Pleading' § 696)."

In *Knoblock* v. *Waale-Camplan Co.*, 141 Cal.App.2d 870, 297 P.2d 765 (2d Dist.Ct.App. 1956), the facts were substantially as those at bar. Plaintiff had loaned money to a subcontractor and, as security, took an assignment of a sum to become due the subcontractor from the prime contractor. The work completed, the prime contractor paid the sum due, not to plaintiff, but rather to the subcontractor, who kept the funds. In affirming a decision holding *two officers* of the subcontractor individually liable,* the Court, after holding that the subcontractor was an involuntary (*e.g.*, constructive) trustee, stated:

> "From the evidence before the court, the conclusion is justified that . . . $2,556 was withdrawn from the corporate funds by checks payable to appellant J. C. Crookshanks. *Both appellants having signed the corporation's checks, both are equally responsible.* Gray v. Sutherland, 124 Cal. App.2d 280, 290, 268 P.2d 754. Both being agents of the corporate trustee, when they thus relieved the corporation of its possession of the trust money, they, individually, were charged with the same duties and obligations as had been imposed upon

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* As here, the corporation of which the defendants were officers was bankrupt.

the corporate trustee. Crenshaw v. Ray C. Seeley Co., 129 Cal. App. 627, 632, 19 P.2d 50; Bridgford v. McAdoo, 48 Cal. App. 305, 306, 191 P. 1113." 297 P.2d at 768.

Here, two of the four appellants were actual signatories to the check which withdrew the penultimate Army Payment (A1621) from the Special Account.* Moreover, Anton admitted that these withdrawals from the Special Account were made "with the knowledge of the directors" (A635-36, 665-66). Under the teaching of *Knoblock*, they would be "equally responsible" in their individual capacities without further knowledge or participation.

POINT II

The District Court properly found that the restriction on Eon's use of the Army Payments and the overall nature of the Special Account arrangement established a fiduciary duty of Eon owed to Teledyne with respect to such funds, a duty which appellants breached when they diverted those funds to pay other creditors.

A. Answering, Initially, The Misstatements Of Law Advanced By Appellants.

1. That a trust must be proved "beyond a reasonable doubt".

Appellants cite three cases for the proposition that the intent to create a trust must be proven "beyond a reasonable doubt" (Br., 20). Since the question of whether a

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* The signatures of two of the four appellants were required on all checks drawn on the Special Account (A1449-50). Anton testified that $216,000—supposed to be used to buy a cashier's check for Teledyne (A646, 1353)—was instead, without approval by or even notification to Teledyne, transferred by check from the Special Account to Eon's New York account at Bankers Trust (A663, 1446, 1475) and then presumably used to pay other creditors of Eon, including the salaries of Anton and his wife (A1475-83, 1500-18, 1534). The last Army Payment—for $81,448.90 (A1622)—was deposited directly in Bankers Trust (A1476), and similarly withdrawn to pay other creditors (*id.*).

trust is created is governed by California law,* the two non-California cases cited by appellants are wholly inapposite. As to constructive trusts, *i.e.*, involuntary trusts "created by operation of law" (*Cal. Civil Code* § 2217), they need only be proved by "clear and convincing evidence," and *not* by evidence "beyond a reasonable doubt." *Sparks* v. *Lauritzen, supra.*

As to voluntary trusts—distinguished from involuntary, *e.g.*, constructive, trusts—appellants are similarly incorrect.

> "[A] voluntary trust is an obligation arising out of a personal confidence reposed in, and voluntarily accepted by, one for the benefit of another." *Cal. Civil Code* § 2216.

As to trustors and trustees of a voluntary trust, the trust is created "by any words or acts [of the trustor or trustee] indicating *with reasonable certainty.*" *Cal. Civil Code* §§ 2221, 2222.

2. That the intermingling of funds precludes a finding of a trust.

Appellants attempt to defeat the obvious fiduciary relationship present at bar by arguing that the "intermingling of funds" precludes a fiduciary relationship.** (Br., 13) This is untenable even as a general statement of the law, and is certainly incorrect as a matter of California law:

> "It is settled as to both express trusts and trusts created by operation of law that an ascertainable interest in a bank account of the trustee in which funds of the trustee *and* of the beneficiary are deposited constitutes an asset definite enough to be the subject matter of a *trust.*" *Garrison* v. *Edward Brown & Sons,* 25 Cal. 2d 473, 154 P.2d 377, 381 (1944).

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* *See Jaffke* v. *Dunham,* 352 U.S. 280 (1957).

** Of course, Teledyne rightfully expected that the Army Payments would *not* be commingled with other funds of Eon (*e.g.*, A1089, 1113, 1115), as the segregation of the Army Payments into the "monitored" Special Account was intended to prevent just this. For this additional reason, then, appellants' argument carries no weight.

3. That the failure to designate Eon "as agent or trustee" in a written trust agreement automatically precludes a fiduciary relationship.

Appellants continue to misstate California law by blithely asserting that no fiduciary relationship can exist where

> "there existed no trust agreement or trust indenture, or express security agreement with any designation of Eon as agent or trustee." (Br., 13)

Initially, it must be recognized that Teledyne is asserting that Eon and the individual defendants breached a fiduciary duty to Teledyne. This fiduciary relationship need not constitute an express trust for Teledyne to prevail. *See Estate of Cover,* 188 Cal. 133, 204 P. 583, 588 (1922). On this ground alone, then, the absence of either a formal document entitled "trust indenture" or "trust agreement" or a specific designation of Eon as "agent" or "trustee" has no bearing on this case. Moreover, in language which bears closely on the facts of this case, the Supreme Court of California cited the following as controlling:

> "In the case of Colton v. Colton, 127 U.S. 300 . . . [t]he court said: 'no technical language, however, is necessary to the creation of a trust, either by deed or by will. It is not necessary to use the words "upon trust" or "trustee" if the creation of a trust is otherwise sufficiently evident. If it appears to be the intention of the parties, from the whole instrument creating it, *that the property conveyed is to be held or dealt with for the benefit of another, a court of equity will affix to it the character of a trust, and impose corresponding duties upon the party receiving the title,* if it be capable of lawful enforcement.' " *In re Reith's Estate,* 144 Cal. 314, 77 P. 942, 943 (1904).

Thus, the confidence reposed in Eon by Teledyne for Teledyne's benefit and the writings between the parties, as interpreted in light of the entire background of this

transaction, establish beyond cavil that a fiduciary relationship and a voluntary trust existed.*

Appellants' oft-stated corollary argument, that the absence of a trust is shown by the fact that "Eon retained all rights of control to its bank account" (Br., 7, 13, 15, 17, 19), does not acquire even a patina of merit through mere repetition. Implicit in the concept of a trustee is control over a trust *res,* but with such power of control to be exercised for the use and benefit of the *cestui.*

B. The Special Account Created A Fiduciary Relationship.

California courts apply the following definition of fiduciary relation:

> "Confidential and fiduciary relations are, in law, synonymous, and may be said to exist whenever trust and confidence is reposed by one person in the integrity and fidelity of another. The very existence of such a relation precludes the party in whom the trust and confidence is reposed from participating in profit or advantage resulting from the dealings of the parties to the relation." *Estate of Cover, supra,* 204 P. at 588.

Similarly, under *California Civil Code* § 2216, "a voluntary trust is an obligation arising out of a personal confidence reposed in, and voluntarily accepted by, one for the benefit of another."

Merely by characterizing it as a "vendor-vendee" or "debtor-creditor" relationship (Br., 5, 11, 17, 24), appellants cannot, as they try, negate the existence of a fiduciary relation as a matter of law. Indeed, looking at some of the pivotal documents here involved—particularly Modification No. 9 to the Subcontract (A1101-02), Leonard's May 25 letter (A1113-14) and Leonard's October 11 letter

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* Other cases relied on by appellants, such as *Johnson* v. *Morris; Donald W. Bauer* v. *Frank; Matter of Tele-Tone Radio Corp.; Van Denbergh* v. *Walker* (Br., 13-15) are inapposite—among other reasons, they do not concern California law.

(A1115-17)—an "obligation arising out of a personal confidence reposed in, and voluntarily accepted by" Eon for the benefit of Teledyne is apparent.* Thus, Eon was to receive property from Teledyne, which property Eon was to sell to the Army, paying Teledyne's invoices from *the specific funds created* by the sale to the Army of the property Teledyne had transferred. There cannot be the slightest doubt that Teledyne was not looking to Eon's general credit or to payment out of Eon's general corporate bank account, but rather anticipated payment only out of specific funds with which it was "associated" and "identified" from out of a special bank account. The following example from the *Restatement (Second) of Trusts* § 5, illustration 2 (1959), while perhaps homely, is most analogous:

> "A transfers to B by deed a farm and all the horses used on the farm, with instructions to B to sell the farm and the horses and to pay the proceeds to A. A trust, not a bailment, of the horses is created."

Thus, *Restatement (Second) of Trusts* § 10, comment *h* negates the existence of a fiduciary relation in such a situation only:

> "Where . . . the transferor does *not* manifest an intention to impose a duty upon the transferee to deal with the property for the benefit of the transferor . . ."

The negative implication of § 10, comment *h* is clear.** A fiduciary relation was created when Teledyne delivered gen-

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* Obviously, Judge Knapp's analysis of the entire course of dealings between the parties further corroborated his interpretation of the operative documents themselves.

** This is an accurate restatement of California case law. In *Whiting-Mead Co.* v. *West Coast Bond & Mortgage Co.*, 66 Cal. App.2d 460, 152 P. 2d 629 (2d Dist.Ct.App. 1944), Dirks, a contractor, delivered a trust deed on property to defendant in consideration for defendant's setting aside a given amount of funds to pay for labor and materials to improve the property. *Held,* a trust was created, one of the beneficiaries of which was Dirks, who therefore had the right to have the funds so set aside *"expended for his benefit"*. 152 P. 2d at 632. To the same effect is *Ralph C. Sutro Co.* v. *Paramount Plastering, Inc.*, 216 Cal.App.2d 433, 31 Cal. Rptr. 174, 176 (2d Dist.Ct.App. 1963).

erator sets to Eon (or rather to the U.S. Army at Eon's request) with the intention that Eon deal with the proceeds (the Army Payments) for Teledyne's benefit.

Thus, as Judge Bauman correctly stated the law, "where a party to a contract undertakes to make payments out of a fund specially segregated for a specified purpose, he acts in a fiduciary capacity." (373 F.Supp. at 202) (A1219).*

Even assuming, contrary to the present record, that the documents referring to the Special Account did not exist, it is well established in California that a trust could still be found, based "solely on inferences from the circumstances, behavior and posterior declarations of transferor and transferee without any indication of what was actually spoken between them." *Casey* v. *Casey*, 97 Cal.App.2d 875, 218 P.2d 842, 847 (1st Dist.Ct.App. 1950). Illustrative of this, in *People* v. *Pierce*, 110 Cal.App.2d 598, 243 P.2d 585 (2d Dist.Ct.App. 1952), in finding a voluntary trust, the Court stated:

> "It is a reasonable inference that defendants *could not have induced the dealers to relinquish the funds without assurance that they would be kept intact* . . . . The inference is clear that Hoffar would not have parted with his $5,000 unless he had been given to understand that his money would be held in trust. He testified that he was told his money would be paid into a bank or reserve and not used." 243 P.2d at 590.

The same conclusion is obvious here. Teledyne, knowing Eon's extremely weak financial position, and knowing that payment could only come from specifically identifiable government funds,** would not have relinquished its prop-

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* *Cf. Downey* v. *Humphreys*, 102 Cal.App.2d 323, 227 P.2d 484, 490 (2d Dist.Ct.App. 1951).

** As Leonard later acknowledged in his October 11 letter to Coleman:

> "For the record you and Harold [Rouse] will remember, we pointed out from our first meetings that American Marc

(footnote continued on following page)

erty in return for the prospect of becoming a general creditor. As an alternative to a preferable—but unfeasible—novation of the Army Contract, Teledyne insisted upon the Special Account for the precise purpose of keeping "intact" the proceeds to which Teledyne was entitled.

POINT III

The District Court properly found, from the undisputed fact that appellants authorized withdrawal of the Army Payments from the Special Account for purposes other than payment of Teledyne's invoices, that appellants were therefore jointly and severally liable for conversion and breach of fiduciary duty.

A. Appellants' Argument That They Are Not Personally Liable, Since At The Time Of Such Withdrawals They Claim To Have Been Ignorant Of The Restrictions On Eon's Use Of The Special Account, Misstates California Law.

Even assuming—contrary to an overwhelming record—that appellants knew nothing of the Special Account's restrictions, such "innocence" would avail them naught, for:

> "The foundation for the action of conversion rests neither in the knowledge nor the intent of the defendant. It rests upon the unwarranted interference by defendant with the dominion over the property of the plaintiff from which injury to the latter results. *Therefore neither good nor bad faith, neither care nor negligence, neither knowledge nor ignorance, are of the gist of the action.*" *Poggi* v. *Scott,* 167 Cal. 372, 139 P. 815, 816 (1914).

See also Edwards v. *Jenkins,* 214 Cal. 713, 7 P.2d 702, 705 (1932).

(footnote continued from preceding page)

> had no money from which to pay TCM [Teledyne] except when it received money from the Government as progress payments, after the shipment or sale of generator sets had been made. . . ." (A1115)

Appellants cite no authority for their half-hearted proposition that it "is respectfully submitted," and "would appear that" the "rationale of *Poggi*" cannot be "applied in a corporate context" and that a director or officer "cannot be held liable for any innocent conversion done within his corporate capacity" (Br., 25, 30).* In *McClory* v. *Dodge,* 117 Cal. App.2d 148, 4 P.2d 223, 225 (3d Dist.Ct. App. 1931), the Court, in upholding the individual liability of directors under facts similar to those at bar, *held:*

> "Certainly directors of a corporation cannot take a man's property, sell it, and convert the proceeds to their own use or to the use of the corporation and escape liability to the owner of the property, by simply saying to him *'You cannot prove that we knew that the property converted by us belonged to you, and therefore we are not liable.'* Surely there is no principle of law or equity that would uphold such an unjust rule."**

As was said in *Granoff* v. *Yackle,* 196 Cal.App.2d 253, 16 Cal. Rptr. 394, 396 (2d Dist.Ct.App. 1961):

> "The applicable law was clearly stated by Mr. Chief Justice Vanderbilt in Hirsch v. Phily, 4 N.J. 405, 73 A.2d 173. . . . [T]he Chief Justice said (73 A.2d 173, at page 177): 'It is well settled by the great weight of authority in this country that the officers of a corporation are personally liable to one whose money or property has been misappropriated or converted by them to the uses of the corporation, although they derived no personal benefit therefrom and acted merely as agents of the corporation. The underlying

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* Appellants discuss only three cases other than *Poggi* (Br., 25-29), each of which holds the individual defendants-directors personally liable in conversion.

** While appellants quote at length from *McClory* (Br., 27-28), it is not surprising that they do not quote this portion of the opinion which totally refutes their position.

> reason for this rule is that *an officer should not be permitted to escape the consequences of his individual wrongdoing by saying that he acted on behalf of a corporation in which he was interested.* 152 A.L.R. 703; 3 Fletcher on Corporations, §§ 1140-1142.' See also Hinkle Iron Co. v. Kohn, 229 N.Y. 179, 128 N.E. 113."

Accord, Price v. *Hibbs,* 225 Cal.App.2d 209, 37 Cal. Rptr. 270, 278 (5th Dist.Ct.App. 1964).

Clearly, appellants would be liable for conversion *whether or not* they were then aware of the Special Account arrangement.

B. Assuming, *Arguendo,* That Appellants' Knowledge Of Teledyne's Interest In The Army Payments Is Somehow Relevant, Under California Law Appellants Are Clearly Presumed, Without Further Proof, To Have Had Such Knowledge.

Appellants concede (Br., 26-29) that California law imposes liability for conversion on corporate officers and directors where the "property" involved is of such corporate importance that the officers or directors are *presumed* to know thereof. *Vujacich* v. *Southern Commercial Co.,* 21 Cal.App. 439, 132 P. 80, 81 (2d Dist.Ct.App. 1913); *Mercer* v. *Dunscomb,* 110 Cal.App. 28, 293 P.836, 839-40 (1st Dist.Ct.App. 1930); *McClory* v. *Dodge, supra* at 225. As was said in *Vujacich, supra*:

> "Where the business of receiving deposits by a corporation is so general as it was with the corporation defendant herein, it must be presumed that the directors had full knowledge of the manner in which such moneys were kept or used. . . ." 132 P. at 81.

It seems clear that the use of the Special Account for the deposit of funds received pursuant to the Army Contract which, according to Anton, "accounted for approximately *50 per cent of Eon Corporation's . . . consolidated . . . gross*

revenues during the years 1970 and 1971" (A1044),* and as a result of a Subcontract which had been of major concern to Eon's board of directors (A605, 708), and kept along with the Special Account documents in Eon's office files in New York (A1016), makes it such a major part of the business as to bring the present facts within the rationale of these cases.

C. Assuming, *Arguendo*, That Such Knowledge Is Somehow Relevant, It Was Overwhelmingly Established At Trial That Appellants Had Timely Knowledge Of The Special Account.

Without any citation to the record—indeed in its teeth—appellants state that

> ". . . the proof established that defendants-appellants were ignorant of the wrongfulness of disbursing the progress payments received from the government to anyone other than Teledyne." (Br., 25)

Even assuming, contrary to law,** that such knowledge is required, the record fairly bristles with evidence supporting Judge Knapp's finding that appellants actually knew*** of the restrictions on the Special Account.****

D. In Like Manner As Appellants Are Individually Liable For Conversion, Their Diversion Of Army Payments Renders Them Similarly Liable For Breach Of Fiduciary Duty.

As has been discussed *supra*,***** the California courts consistently impose upon corporate directors the duty to in-

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* Moreover, since Eon was operating at a deficit, the Subcontract, under which, as Anton testified, Eon stood to make a profit of $32/unit on 4400 units (Tr1789), assumed critical importance to Eon's viability.

** *See* Point III, A, *supra*.

*** As to what appellants were presumed by law to know, *see* Point III, B, *supra*.

**** *See* extensive discussion of the record on this point, *supra* at 20-25.

***** *See* Point III, B, *supra*.

quire into the operations of their business. *McClory* v. *Dodge, supra*; *Mercer* v. *Dunscomb, supra*; *Vujacich* v. *Southern Commercial Co., supra.* Moreover, the law *presumes* that directors know of the manner in which major details of the business are conducted. *Vujacich* v. *Southern Commercial Co., supra,* 132 P. at 81. A director will be held liable for his participation in a breach of fiduciary duty if he fails reasonably to protest and to take steps to prevent such loss. As Professor Scott states:

> "[T]he mere fact that he [the director] is guilty of inaction rather than of intentionally wrongful or negligent action should not necessarily excuse him from liability. The beneficiaries are entitled to rely upon a reasonable degree of activity by the officers of the institution to which the care and management of their property is committed." 3 A. Scott, *Law of Trusts* § 326.3, at 2566-2567 (3d ed. 1967).

As authority for this proposition, Professor Scott cites *Mercer* v. *Dunscomb, supra.**

Thus, appellants, who were aware of—and indeed approved—Eon's use of the Army Payments to pay creditors other than Teledyne, are liable for participating in Eon's breach of trust. Further, Leonard's letter to Srybnik (A1352-54) was by itself sufficient, under the principles stated above, to put Srybnik on notice that there was a breach of trust and to impose consequent liability. Either his consent to the diversion of these trust funds** or his failure to protest when put on notice thereof, would alone

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* *See also* 3 Fletcher, *Cyclopedia of the Law of Private Corporations* § 1141 (1965 rev.).

** Moreover, the equitable assignment of the Army Payments constituted Eon a fiduciary for Teledyne's benefit. *Hinkle Iron Co.* v. *Kohn, supra,* 229 N.Y. at 183. *Cf. Hoffman* v. *Vallejo,* 45 Cal. 564, 572 (1873). In *Hinkle,* a leading case cited with approval in *Granoff* v. *Yackle, supra,* the court found a director individually liable, stating:

> "The corporation received and deposited the assigned sum in a trust capacity, because the sum was equitably the property of

(footnote continued on following page)

constitute sufficient participation in or ratification of the breach of fiduciary duty to create liability. As Professor Scott states:

> "If, indeed, he knew that breaches of trust were being committed by the corporation and took no action to prevent such breaches of trust or to protect the interests of the beneficiaries, it seems clear that he is liable to the beneficiaries." 3 A. Scott, *Law of Trusts* § 326.3, at 2566 (3d ed. 1967).

This would apply *a fortiori* to Anton, Eon's President, who was in charge of its day-to-day operations (A715), who actively involved himself in the Subcontract negotiations and who instigated the diversion of the Army Payments (A599, 647, 663).

POINT IV

Answering appellants' Point IV (that afterwards Teledyne refused to accept a return of part of the funds converted): even if factually correct, as a matter of law such a "tender" will not defeat a conversion action or reduce the damages for conversion.

Appellants claim that Teledyne refused to accept payment from Eon of $216,000 *after* "Eon removed progress payments from [the Special Account] and utilized the money to pay other corporate obligors." (Br., 34) Appellants next contend that

> ". . . Teledyne's refusal of the tender . . . is sufficient to reduce Teledyne's judgment by $216,000, the amount of the tender. Having once refused the money, appellee cannot now be heard to claim that appellants converted same." (Br., 37)

(footnote continued from preceding page)

the plaintiff, which the corporation, as the owner of the legal title, was authorized to receive and hold only for the purpose of delivery to the plaintiff. After payment the sum was in the possession of the corporation as a special deposit or bailment for the benefit of the plaintiff." 229 N.Y. at 183.

The law is otherwise.

It is settled that once a conversion has taken place

> "[a]ny *subsequent* offer to return the property would be *ineffectual* as a defense." *Webster* v. *Scheidt,* 105 Cal.App.2d 520, 233 P.2d 603, 605 (4th Dist.Ct.App. 1951).

Accord, Everfresh Inc. v. *Goodman,* 131 Cal.App.2d 818, 281 P.2d 560, 562 (2d Dist.Ct.App. 1955).

Moreover, a thorough review of the record nowhere discloses any evidence, or even suggestion, that such a "tender" in fact took place. While appellants state that $216,000 was "tendered", the pages of the record they cite for this proposition (A882-83) contain no such figure—nor do any other pages in the record.* Apparently, appellants' counsel (who were not trial counsel) mistakenly assume that the $216,000 check payable to the Bank of America, originally prepared for purposes of purchasing a cashier's check payable to Teledyne (A663, 1446) but later cancelled at appellants' direction (A1446), was later tendered in settlement. This is simply not true, nor is it consistent with appellants' admissions that the last two Army Payments *had to be* diverted to pay other more pressing debts (A647, 667).

Finally, at that point in time, Teledyne had a much larger claim against Eon for fraudulent inducement and for contractual damages (A11). Any unaccepted offer to settle for a fraction of the total amount owed—even if the offer amounted to the sum converted—could obviously not serve to absolve the appellants from their liability in conversion.

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* In fact, Eon's corporate bank accounts on July 17 and 18, 1972—the dates of appellants' meetings with Teledyne's counsel where the alleged "tender" occurred—reveal that there was an aggregate total in *all* Eon accounts of substantially less than $216,000 (A1476, 1520, 1551). Coleman testified that, at the June 29, 1972 meeting, Anton indicated that Eon had no cash with which to repay Teledyne (A469). Kotts testified that on June 29 Anton said the Special Account had only $10,000 left in it (A563), a fact confirmed by the check stubs for the Special Account (A1447).

POINT V

Answering appellants' Point V (bankruptcy *res judicata* argument): two District Court Judges and one Bankruptcy Judge have already held appellants' position to be completely meritless.

It is not surprising in view of appellants' other misstatements of law and fact that they now burden this Court with a tired rehash of their makeweight "argument" that the Bankruptcy Court had exclusive jurisdiction of this action, despite the independent holdings of Judges Bauman and Knapp that such an "argument" is completely meritless, indeed, even "specious" (373 F.Supp. at 203, 401 F. Supp. at 733, 735) (A1222, 31, 34), and despite Bankruptcy Judge Price's unappealed refusal of appellants' request to stay trial of this action (A33).

A. Section 311 Of The Bankruptcy Act, 11 U.S.C. § 711, Confers Summary Jurisdiction On The Bankruptcy Court Only Over That Property In The Actual Or Constructive Possession Of The Debtor At The Time Of Filing The Petition In Bankruptcy.

Bankruptcy proceedings are "proceedings *in rem*" (*Hanover National Bank* v. *Moyses,* 186 U.S. 181, 192 (1902)) and it follows necessarily that the Bankruptcy Courts

> ". . . have summary jurisdiction to adjudicate controversies relating to property over which they have actual or constructive possession. And the test of this jurisdiction is not title in but *possession by the bankrupt at the time of the filing of the petition in bankruptcy.*" *Thompson* v. *Magnolia Petroleum Co.*, 309 U.S. 478, 481 (1940).

Accord, In re Adolf Gobel, Inc., 80 F.2d 849, 852 (2d Cir. 1936). Therefore, the Bankruptcy Court's jurisdiction extends only to property under its control, and the Bankruptcy Court

> ". . . does not acquire summary jurisdiction if the

property does not belong to the debtor and is not in his possession. . . ." *Slenderella Systems, Inc.* v. *Pacific Telephone & Telegraph Co.*, 286 F.2d 488, 490 (2d Cir. 1961).

There is no question that the Army Payments were disbursed by Eon—at appellants' directions—to pay creditors other than Teledyne well prior to the date Eon filed its petition in bankruptcy.* Thus, since the funds represented by the Army Payments were not in Eon's actual or constructive possession on the date of the filing of the petition, nor indeed even within the preceding four months, the Bankruptcy Court acquired no jurisdiction over these funds and has no jurisdiction in this action at bar concerning those funds.**

B. Even If The Bankruptcy Court Had Jurisdiction To Decide Teledyne's Claims Against Eon, It Recognized That It Was Without Jurisdiction To Stay This Action From Proceeding Against Appellants.

Appellants argue (Br., 39-40) that Teledyne in this proceeding is somehow stripping "the Bankruptcy Court of its power and jurisdiction by personally attacking the directors of the corporation. . . ." This argument, too, is specious.

It has been repeatedly held that, since the Bankruptcy Court acquires summary jurisdiction over the property of the debtor *only (supra),* the Bankruptcy Court has no jurisdiction over controversies where the bankrupt is not a party and no relief is sought against the bankrupt's property, even though there may be an incidental effect on Eon. As was said in *Evarts* v. *Eloy Gas Corp.*, 204 F. 2d 712 (9th Cir.), *cert. denied,* 346 U.S. 876 (1953):

"The Bankruptcy Court has no jurisdiction in controversies between third parties not involving the

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* Eon's filing followed the institution of this action by more than six months (A1207).

** Appellants concede this pre-bankruptcy payout (Br., 34), a fact which alone renders moot their further bankruptcy discussion.

debtor or his property [citing authorities]." 204 F.2d at 717.*

In fact, Bankruptcy Judge Price, presiding over Eon's Chapter XI Proceeding, specifically refused appellants' prior counsel's *ex parte* request for a stay against Teledyne's continued prosecution of this action against them. Judge Bauman also denied their request for similar relief made herein (373 F.Supp. at 203) (A1222-23).

C. The Bankruptcy Proceeding Is Not *Res Judicata* As To This Action, Nor Does Collateral Estoppel Apply.

The doctrine of *res judicata* means that

> ". . . a judgment 'on the merits' in a prior suit involving the same parties or their privies bars a second suit *based on the same cause of action.*" *Lawlor* v. *Nat'l Screen Service,* 349 U.S. 322, 326 (1955).

Under the collateral estoppel doctrine,

> ". . . such a judgment [on the merits] precludes relitigation of issues *actually litigated and determined* in the prior suit, regardless of whether it was based on the same cause of action as the second suit." *Id.*

Moreover, collateral estoppel requires for its application that

> "It must be confined to situations where the matter raised in the second suit is identical *in all respects* with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged." *Commissioner* v. *Sunnen,* 333 U.S. 591, 599-600 (1948).

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* *Accord, In re Nine North Church St., Inc.,* 82 F.2d 186, 189 (2d Cir. 1936); *In re 1775 Broadway Corp.,* 79 F.2d 108, 110 (2d Cir. 1935); *Chauncey* v. *Dyke Bros.,* 119 F. 1, 3 (8th Cir. 1902); 8 *Collier on Bankruptcy,* ¶ 302 n.2, at 157-8 (14th ed. 1975). In *Chauncey* v. *Dyke Bros., supra:*

> "The bankruptcy court had no right to assume jurisdiction of a controversy between third parties, in which the trustee was not concerned . . . merely because the claimants happened to be creditors of the bankrupt estate, or merely because the liens [involved] affected a part of the bankrupt's property. The bankruptcy act confers no such authority." 119 F. at 3.

Both doctrines are inapplicable here.*

Initially, only Teledyne and Eon are bound by Bankruptcy Judge Price's Confirmation Order, which could and did decide only the limited issue the Bankruptcy Court is statutorily authorized to determine—whether the already accepted plan of arrangement was feasible and in the best interests of the *entire class* of all general creditors, *i.e.*, would benefit them more than would a straight liquidation.** The Confirmation Order did not purport to—nor could it—decide the liability of appellants (or even Eon) to Teledyne for their individual torts. Nor were issues of appellants' conversion or breach of fiduciary duty ever raised in the Chapter XI proceeding. In light of Point V, A, *supra*, this necessarily follows since the Bankruptcy Court had no *in personam* jurisdiction over this action against appellants.

CONCLUSION

The judgment of the District Court should be affirmed.

Respectfully submitted,

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* Judge Knapp, in stronger language, found this argument of appellants to be "specious" (401 F.Supp. at 735) (A34).

** § 366(2) of the Bankruptcy Act, 11 U.S.C. § 766(2); 14 *Collier on Bankruptcy* ¶ 11-38.05[3] (14th ed. 1976). The transcript of the hearing on Eon's Plan of Arrangement is part of the record on appeal, being Exhibit 2 to a Stipulation and Order signed by Judge Knapp on September 16, 1975. A reading of that transcript shows that no issues of Eon's (much less appellants') conversion or breach of trust were ever raised (*see particularly* p. 8 thereof).

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

TELEDYNE INDUSTRIES, INC.,
Plaintiff-Appellee,
against

ODIF PODELL, SIMON SRYBNIK, NICHOLAS ANTON,
SAUL WALLER,
Defendants-Appellants,
and

EON CORPORATION and KERNS MANUFACTURING CORP.,
Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

AFFIDAVIT OF SERVICE

STATE OF NEW YORK,
COUNTY OF NEW YORK, ss.:

Jerry N. Simmons, being duly sworn, deposes and says that he is over the age of 18 years, is not a party to the action, and resides at 25 Elliott Place, Bronx, New York 10452

That on November 8, 1976, he served 2 copies of BRIEF OF PLAINTIFF-APPELLEE

on

TRUBIN, SILLCOCKS, EDELMAN & KNAPP, Esqs.
375 Park Avenue
New York, New York

by delivering to and leaving same with a proper person or persons in charge of the office or offices at the above address or addresses during the usual business hours of said day.

Jerry N. Simmons

Sworn to before me this
8th day of November, 1976

John V. D'Esposito

JOHN V. D'ESPOSITO
Notary Public, State of New York
No. 30 0932850
Qualified in Nassau County
Commission Expires March 30, 1977